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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

Texas Office of Public Utility Counsel's
Initial Comments

January 29, 1997

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I. INTRODUCTION

The Texas Office of Public Utility Counsel (OPC) represents residential and small business consumers in telephone proceedings before the Texas Public Utility Commission, the Federal Communications Commission (FCC) and in various state and federal courts. OPC submits these comments in response to the "Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry," In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, Usage of the Public Switched Network by Information Service and Internet Providers, CC Docket Nos. 96-262, 94-1, 91-213, 96-263, December 24, 1996, (hereafter, the Access Charge Notice).

A. Consistent Principles Of Pricing Should Be Adopted Across All of the FCC's Rulemakings

For ease of presentation, these comments are organized around several major themes which are raised by the Access Charge Notice. Moreover, in these comments OPC will stress the fundamental consistency in its recommendations on local competition,[1] universal service,[2] and access charge reform. Indeed, OPC urges the FCC to apply a consistent set of principles.

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1 "Initial Comments of the Texas Office of Public Utility Counsel," In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, May 16, 1996 (hereafter Local Competition).

2 "Initial Comments of the Texas Office of Public Utility Counsel." In the Matter of Federal-State Joint Board on Universal Service, FCC Docket No. 96-45, April 12, 1996 (hereafter Universal Service).

The principles that have guided OPC's previous comments and which are central to these comments can be briefly summarized as follows.

- o Input prices should be based on efficient, best available technology. On-the-shelf, efficient technology is what drives prices in competitive markets and this principle must drive regulatory pricing in the transition to competition.

- o Sharing of costs between services that use joint and common facilities across jurisdictions remains sound economic and public policy.

- o All forms of "make-whole" regulatory policies should be rejected because they are anti-competitive and anti-consumer.

- o Simplicity in pricing inputs is crucial because the telecommunications market clearly shows a tendency toward simplicity in pricing outputs.

- o The FCC must exercise leadership in promoting competition while it allows states flexibility in directing the movement toward competition.

II. EFFICIENT PRICING STRUCTURES

A. Input Prices Should Be Based On Efficient, Best Available Technology. On-The-Shelf, Efficient Technology Is What Drives Prices In Competitive Markets and This Principle Must Drive Regulatory Pricing In The Transition To Competition.

Access charge reform is the third of the pillars of regulatory reform on which the Federal Communications Commission has proposed to build the telecommunications industry of the twenty-first century. In the first two proceedings, local competition and universal service, the Commission and the Joint Board have chosen efficient, forward looking prices as the cornerstone of competition. Texas OPC has supported and applauded the decision to use efficient, forward looking prices as the rudder to steer public policy toward competition. We again urge the Commission to vigorously adopt and enforce efficient pricing.

In the local competition comments OPC put forward the following principles for pricing of network elements, which we believe should be applied to access charges as well.

> Rates should be determined using an economic measure of cost, such as TSLRIC, and apply non-discriminatorily to all competitors, and the incumbent LEC itself. The cost of money included in TSLRIC, is a reasonable profit. Pricing principles should apply equally to interconnection and unbudnled network elements.[3]
>
> LRIC: The full amount of incremental investment and expenses incurred by reason of furnishing additional quantities of service, in the long run, and using least cost technologies.
>
> TSLRIC: The same as LRIC, provided that the "ional quantities of service" are specified as the total output for the service (or network elements). This term is equivalent to LRSIC.
>
> Forward-looking cost: Cost determined on the basis of state-of-the-art, least cost but currently available technologies, because these reflect the true social costs (Forward looking costs stand in contrast to embedded costs, which are based on the actually used and useful technologies).[4]

OPC views network access and all of its components (loop, switching, transport, etc.) as inputs into the production of a service -- long distance. As such, OPC recommends that the same cost/pricing principles applied to interconnection and unbundling be applied to access. Without a consistent set of principles, competition will be distorted in the two major industry segments -- local and long distance. If the Commission does not follow the same regulatory

3 OPC, Local Competition, p. 17.

4 OPC, Local Competition, pp. 21-22.

approach across all of the markets it regulates, the possibility for gaming will increase substantially and incentives to delay competition will be increased.

B. The Commission Cannot Rely On Market Forces To Impose Efficient Pricing Of Network Access On Incumbent LECs

OPC supports the Commission's goal of fostering vigorous competition in all segments of the telecommunications industry. However, OPC does not believe that competition can be relied upon to compel incumbent LECs to price access efficiently. The Commission cannot rely on competition for access to promote efficient pricing before there is full and effective competition for local service.

The current recovery of costs for access are grossly uneconomic and to the benefit of incumbent LECs. Incumbent LECs continue to hold virtual monopolies in the loop and switching functions which are necessary to provide network access. They will inevitably exercise every shred of market power they posses to defend their uneconomic recovery of costs. If they are allowed to continue to collect uneconomic access charges at their own discretion, they will have yet another incentive to impede competition. While competition will slowly erode their ability to hold onto their uneconomic cost recovery, those who have the fewest competitive alternatives will suffer longest.

If the Commission fails to prescribe an efficient pricing structure for access, it will prolong and delay the advent of full and effective competition in both the access and local exchange markets. We recommend a prescriptive approach to access charge reform. Moreover, we believe that anything short of fully effective competition will fail to discipline anti-competitive and anti-consumer pricing practices.[5] Therefore, the commission should make actual competition the requisite for any regulatory relief in access pricing. It is only the advent of actual competition that merits a reward under the Act. Actual competition is part of the standard for allowing in-region long distance under section 271.

Therefore, OPC recommends that rather than reward merely the potential for competition (see Table 1), the Commission adopts a policy that insists that access charge reform be completed before section 271 relief is granted. If access is not priced at the efficient levels a competitive market would produce, there cannot be a condition of non-discrimination between ILECs and IXCs. If access is not priced at the efficient levels a competitive market would produce, then the IXCs are paying an above market price, the benefits of which the ILECs enjoy. Therefore, an ILEC must show either that its prices are at efficient, competitive levels or that the market for access is fully competitive before the Commission can conclude that IXCs are not facing discriminatory pricing of access.

[5] We find it particularly troubling that the Commission is contemplating rewarding the LECs for establishing the conditions for competition, which it equates with "potential" competition. OPC believes that the Commission's proposal to reward the advent of potential competition with significant pricing flexibility undermines the fundamental structure of the Act of 1996. Potential competition as defined by the Commission is nothing more than the fundamental obligations which the Act of 1996 imposed on the incumbent LECs in section 251. They deserve no reward for meeting these conditions.

OPC made precisely this point in its Local Competition comments.

> For example, if rates for interconnection services and unbundled elements are set above costs (TSLRIC) then the incumbent LECs would implicitly enjoy lower costs for these services and network elements. This type of discrimination would result in a competitive advantage for incumbent LECs and hamper the further development of local exchange competition.[6]

OPC has already drawn an analogy between network access and unbundled elements and interconnection. Thus, we believe the same conclusion applies. Moreover, the Commission recognizes this fundamental problem in the question it raises about the potential for price squeeze.[7] In essence, as long as access prices are above costs and the access market is not fully competitive, a price squeeze is inevitable.

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6 OPC, Local Competition, pp. 38-39.

7 Access Charge Notice, para 148.

TABLE 1:
THE FCC'S STAGES OF COMPETITION AND DEREGULATION OF ACCESS

STAGE	MARKET STRUCTURE	ACCESS PRICING
POTENTIAL COMPETITION	Deaveraged, economic elements Transport and termination at additional costs Wholesale and resale at avoided cost Rapid, volume provisioning of network elements Dialing parity Number portability Access to right of way Non-discriminatory and open standards and protocols	Deaveraged prices for access Volume & term discounts Contract tariffs Deregulate innovative services
ACTUAL COMPETITION	Presence of competition Competitively neutral universal service support Enforcement of pro-competitive rules	Eliminate price cap services within baskets Differential pricing allowed Flexible rate structure for transport and switching Consolidating TS and trunking baskets.
SUBSTANTIAL COMPETITION	Market share analysis Demand responsiveness Supply responsiveness (Product and geographic market-by-market, unspecific metric)	Deregulation

III. LOOP COSTS

A. Sharing of Costs Between Services That Use Joint and Common Facilities Across Jurisdictions Remains Sound Economic and Public Policy.

1. The Loop Is A Common Cost

OPC has consistently argued that the loop is a common cost for all telecommunications services that utilize it. In our universal service comments we made the following observations:

> The loop is a telecommunications facility used to complete all telephone calls -- local, intraLATA long distance, and interLATA long distance. It is also used to provide enhanced services. It is impossible to complete an interLATA long distance call without a loop. When the loop is in use to complete an interLATA long distance call, it cannot be used to complete another call.[8]
>
> In its Local Competition comments, OPC defined these costs as follows:
>
> Joint cost: Costs incurred in the provision of two or more services, that are not captured in the incremental costs of each service individually when the services are produced in fixed proportions
>
> Common cost: Costs, incurred in the provision of two or more services, that are not captured in the incremental costs of each service individually when the services can be produced in variable proportions.
>
> Shared cost: Generic terms for costs that are shared between two or more services that are not captured in the incremental costs of each service individually. For example, joint and common costs.[9]

The Commission has now formally recognized this fundamental characteristic of the loop in both the Local Competition rule and the Access Charge Notice.

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[8] OPC, Universal Service, p. 6.

[9] OPC, Local Competition, pp. 21-22.

> The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once those facilities are installed to provide one service they are able to provide the other at no additional cost.[10]

> For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The cost of these elements are, therefore, common to the provision of both local and long distance services.[11]

2. Loop Costs Must Be Recovered From Interexchange Carriers

OPC believes that the allocation of loop costs to the federal jurisdiction falls squarely under section 254 (k) of the Act of 1996. That section imposes two fundamental conditions on the sharing of common costs between basic service and other competitive services. First, no competitive service can be the recipient of a subsidy. Second, basic service can bear no more than a reasonable share of joint and common costs. OPC made this clear in the universal service proceeding.

> Section 254 (k) adds a further dimension to the definition of just, reasonable and affordable by specifying the allocation of joint and common costs between services defined as universal service and competitive services.

> The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more thana reasonable share of the joint and common costs of facilities used to provide those services.

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10 First Report and Order: Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, para. 678 (hereafter, Local Competition Order.)

11 Access Charge Notice, para. 237.

> The conference report makes a point of stating that in adopting Section 254 (k) the House is receding to the Senate (1996 Law, p. 134). The Senate report made it clear that a reasonable share of joint and common costs was the maximum that should be included in the rates for universal service, but less could be allocated to those services.
>
> The commission and the states are required to establish any necessary cost allocation rules, accounting safeguards, and other guidelines to ensure that universal service bears no more than a reasonable share (and may bear less than a reasonable share) of joint and common costs of facilities used to provide both competitive and non-competitive services.[12]

With loop costs clearly established as a common cost and Congress emphatically requiring that competitive services bear at least a reasonable share of such costs, and perhaps even more, there can be no doubt that loop costs must be recovered from providers of long distance service.

Following from this clear legal and economic reasoning, we recommend that the FCC retain the allocation of 25 percent of loop costs to the federal jurisdiction. This allocation is consistent with the long standing Commission policy and we believe reflects the fundamental fact that long distance service has historically imposed higher costs on the engineering and design of the network. It is certainly consistent with the Congressional mandate that competitive services bear at least a reasonable share of such costs and perhaps even more.

B. The Subscriber Line Charge Should Be Eliminated

Furthermore, we recommend, as we did in the Universal Service proceeding, that these loop costs be recovered from IXCs. The subscriber line charge (SLC) should be eliminated.

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12 OPC, Universal Service, pp. 3-4.

> As the market becomes more competitive, the Commission will have to abandon subscriber line charges altogether and allow costs for the provision of loop to be recovered by service providers in the rates they charge each other and their customers. The line item that the Commission has placed on a user's bill for the subscriber line charge cannot be properly placed on the bill, if a competitive company provides loop facilities. Because neither the FCC nor the states has or will regulate the rates of these competitive companies, there is no way that the FCC can know whether $3.50 or $6.00 or any other number is just and reasonable.[13]

Now is the time for the subscriber line charge to be eliminated so that the playing field can be leveled for competition. In this way, loop costs would be recovered from two entities, local and long distance companies, who are soon to be competing with one another. Recovering these input costs from suppliers will also place local and long distance companies on an equal footing with other potential providers of loop services. New entrants who provide loop cannot charge consumers a subscriber line charge. Eliminating the subscriber line charge eliminates the wedge between the cost of loop and the costs the traditional service providers (ILECs and IXCs) who use it incur.

C. The SLC Could Be Eliminated To Ensure A Pass Through Of Aggregate Reductions In Access Charges

OPC believes that the SLC should be eliminated because it was inappropriate in the first place and is inconsistent with a competitive market. There is a second manner in which the SLC could be lowered or eliminated.

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13 OPC, Universal Service, p. 10.

The SLC could also be eliminated as a mechanism to ensure that reductions in access charges for switching or transport services are passed through to consumers. As described below, OPC recommends that all charges be moved to the efficient levels. This will result in a reduction of the costs that long distance companies bear. The Commission should require that these costs are passed through to ratepayers. However, because the Commission no longer regulates rates and in light of the consistent pattern of price increases for basic long distance service for the past four years, we believe the Commission must find a mechanism to ensure consumers see the benefits of access charge reductions. The only rate element that the Commission regulates directly on the consumer bill is the SLC. Therefore, the SLC could be lowered by an amount equal to the reduction in switching costs.

D. Raising The SLC On Second Lines Is Bad Economic and Social Policy

The Commission has already laid the basis for the efficient pricing of loop. With loop set at TELRIC and allocated to IXCs as a cost of business, there is no need or reason to raise the SLC, as contemplated in the Access Charge Notice.[14]

As a matter of economics; second lines are far less costly than first lines. That is, the incremental cost of providing a second line is far less than the cost of the first line, given current technology and deployment. Digital technology allows provision of additional channels at lower costs. As the medium used for loop shifts to coaxial cable and fiber, the cost of additional lines will decline even further. Current pricing practices, which do not discount second lines, means

[14] Access Charge Notice, Para. 65.

that the price-cost margin on second lines are already much higher than for first lines. Thus, the suggestion that SLC should be raised on second lines makes no economic sense.

As a matter of social policy, increasing the SLC on second lines could impose a severe cost on multi-family households. Two families sharing the same household could well have two lines, each of which is the primary line. Why should one be charged a higher SLC?

Raising the SLC on second lines may also have a perverse effect on competition. Since the Commission cannot impose the SLC on competitive local exchange service providers, increasing the SLC on second lines could convince some customers, who want multiple lines, to switch to a competitor. This is, in effect, uneconomic bypass of the incumbent brought about by an increase in an uneconomic cost imposed on end users.

E. Loop Charges Should Not Be Deaveraged

The Commission's desire to deaverage rates is inconsistent with actual market practices, social policy as embodied in the Act of 1996, and unnecessary if the Commission reforms the SLC in the proper fashion.

The notion that every product is sold at some deaveraged price in the market is simply wrong. Many goods are sold at uniform prices in spite of significant variations in cost. The result is not a subsidy, but a differential mark-up. Any effort by the Commission to deaverage prices will result in massive administrative exercises that companies in competitive markets do not undertake.

Moreover, to the extent that there is a substantial problem of cost difference between areas, there are other policy mechanisms to address this problem. The fundamental problem of high cost areas will be addressed in the Universal Service Docket. Deaveraging SLC costs would complicate the calculation of necessary subsidies. It would complicate and perhaps violate the Congressional intention to ensure that rates be reasonably comparable between rural and urban areas. It would certainly make it more difficult for long distance companies to maintain geographically averaged rates, as require by section 254 (g) of the Act of 1996.

Ultimately, if the Commission does away with the SLC altogether, and guarantees a pass through to consumers of this immediate benefit, it will not have to deal with the problem of deaveraging the SLC.

F. Common Line Costs Can Be Recovered As Flat Rate Charges For IXCS

OPC has recommended that the entirety of loop costs recovered in the Federal jurisdiction be recovered from providers of long distance service. OPC believes that the Commission could design a flat rate approach to recovering these costs, as contemplated by the Commission,[15] if cost causal analysis shows that this is the proper approach. OPC outlined this possibility in its Universal Service comments.

> First, it is clear that when customers obtain telephone service they intend and expect to be able to place long distance calls just as much as local calls. The costs of loop are caused by both types of calls.

15 Access Charge Notice, para. 60-63.

> Second, not only are the costs caused by the desire to place long distance calls, but the revenue opportunity created by the placing of calls is dictated by the nature of the use to which the loop is put. The more a facility is in use to complete a long distance call, the less the opportunity to complete other types of calls.
> Thus, the nature of cost causation, revenue opportunities and cost allocation must be analyzed by the Commission before any change in the EUCL and the CCL are made.[16]

To the extent that the costs of loop are fixed, then they could be transformed into a fixed charge, perhaps a channel charge, which essentially charges for the capacity to place calls. To the extent that the revenue opportunity in the use of the loop is variable, it might well make sense to recover the costs on a variable basis. The current recovery of loop costs is split between a fixed and variable component. The SLC is the fixed and the CCL is the variable component of the overall recovery of loop costs allocated to the federal jurisdiction.

IV. SWITCHING COSTS

A. Switching Costs Should Be Set At Efficient Levels

OPC believes that a similar set of principles should be applied to switching costs. That is, they should be based on efficient, forward looking, best available technology. They should be based on cost causation and require the allocation of joint and common costs, where they exist.

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[16] OPC, Universal Service, p. 9.

The FCC has suggested an upper limit on switching costs at approximately $.004 per minute.[17] With usage currently at approximately 500 billion minutes,[18] efficient switching costs would be approximately $2 billion. This means a reduction of approximately $2.2 billion in the total switching cost.[19]

B. Eliminating the TIC

With respect to the Transport Interconnection Charge (TIC),[20] OPC argued the following:

> Because most, if not all, of the TIC is a "make-whole subsidy" this rate element too should be eliminated. TIC should be eliminated, particularly because the Act rejects rate-based costing the type of which the TIC represents, perhaps, the worst example.[21]

Since we view the TIC as a "make-whole" issue, we support the Commission's intention to reallocate TIC costs to appropriate cost elements and eliminate uneconomic cost recovery. The elimination of uneconomic TIC costs does not need any justification, other than the fact that the charges are uneconomic and anti-competitive. Exogenous cost changes[22] will be irrelevant if the Commission adopts a consistent set of competitive principles.

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17 Local Competition Order, para 811.

18 Federal Communications Commission, Statistics of Common Carriers, Table 2.6.

19 Access Charge Order, Table 1.

20 Access Charge Notice, para. 117.

21 OPC, Local Competition, p. 31.

22 Access Charge Notice, para 121.

C. The FCC Could Eliminate the SLC Entirely As A Result Of A Move To Efficient Pricing Combined With A Guaranteed Pass Through Of Cost Reductions

If the FCC is not persuaded to eliminate the SLC on the basis of the fact that loop costs are properly recovered from long distance service providers as an input cost of doing business, OPC believes that there is an alternative line of reasoning that can lead to the elimination of the SLC.

1) The FCC could move the estimation of loop costs to an efficient basis (TELRIC).

2) It could split the recovery of those costs between end users and long distance service providers as it does today.

3) It would also move switching costs to efficient levels.

4) It is would then require the pass through of the cost reduction enjoyed by the long distance service providers in the form of the elimination of the SLC.

The IXCs would pay efficient switching costs ($.004 per minute). They would pay all of the loop costs allocated to the federal jurisdiction (which we believe is sound policy). Utilizing TELRIC estimate for switching and loop in Texas, elimination of the SLC would be accomplished as described in Table 2.[23]

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[23] The Texas estimate of loop cost is $15.00 (Docket Nos. 16189, 16196, 16226, 16285, and 16290, Petition of MFS et. al for Arbitration Pursuant to the Federal Telecommunications Act of 1996, Nov. 7, 1996). The embedded cost of the loop is approximately $35.00 (see "Reply Comments of the Texas Office of Public Utility Counsel", In the Matter of Federal-State Joint Board on Universal Service, FCC Docket No. 96-45, April 12, 1996). Thus, for Texas TELRIC is approximately 43 percent of embedded cost. We assume this for purposes of estimating national average changes in interstate loop costs.

TABLE 2
TELRIC PRICING OF INTERSTATE COSTS AND THE ELIMINATION OF THE SUBSCRIBER LINE CHARGE

FACILITY	CURRENT COST	BASIS OF CHANGE	FUTURE COST	ALLOCATION	IXC	END-USER
Loop	10.8	TELRIC	4.6	50/50 Split End-User/IXC	2.3	2.3
Local Switch	4.2	TELRIC	2.0	Allocate Reduction To End-Users	4.3	.1
TIC	2.9	TELRIC	Unknown Reduction	Allocate Reduction To End-Users	4.6	0

V. PRICING PRINCIPLES

A. Simplicity In Pricing Inputs Is Crucial Because the Telecommunications Market Clearly Shows A Tendency Toward Simplicity In Pricing Outputs.

The Commission seems extremely concerned with increasing the component of variable costs in the overall scheme of cost recovery in the federal jurisdiction. Yet the Commission recognizes the extreme complexity of making the distinction between variable and fixed costs. The Commission seems to be concerned about variations in costs that are dependent on functionality,[24] use,[25] technology[26] and time of day.[27]

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24 Access Charge Notice, para. 72.

25 Access Charge Notice, para. 73.

While OPC supports cost causal analysis as the basis for assigning costs,[28] we also believe that this drive to ascribe variability to costs and a usage basis of costs is fundamentally inconsistent with the actual nature of costs and the direction of pricing in the telecommunications market. While in theory prices are variable in the long term, in practice much telecommunications plant is lumpy. It is purchased in large increments that exhibit economies of scale and scope. Large quantities of capacity are purchased and those decisions are not driven by usage. As OPC noted in its comments on Local Competition

> Clearly, if much of these costs of the incumbent LECs' network are capacity costs rather than usage sensitive costs, then the incumbent LECs will experience very low marginal costs for many of their services. Because, in a truly competitive situation (such as bidding for contracts with customer specific pricing) prices may go down to marginal costs, the incumbent LECs may have a decisive advantage over dependent competitors. That is, if dependent competitors must use the incumbent LECs networks for essential inputs, and if those inputs are price based on average usage, then new entrants' marginal costs will in effect be based, in part, on incumbent LECs' average costs, which are greater than the incumbent LECs' marginal costs.

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26 Access Charge Notice, para. 89.

27 Access Charge Notice, para. 90.

28 OPC, Local Competition, p. 36

> OPC is in agreement with the Commission's initial conclusions that (1) rate-structures should reflect cost causation; (2) rate-structures that do not reflect cost-causation may result in subsidies between users, and thus violate the pricing directives of the Act of 1996 that rates be cost based; (3) rate-structures that do not reflect cost causation may distort the competitive process.

> This situation can be avoided, in part, if new entrants can purchase network elements (or interconnection services) based on capacity (for example, local switching based on a per port basis rather than per minute of use). In this case, new entrants would face a cost structure that is identical, or largely similar, to the incumbent LEC's; both would have marginal costs substantially below average costs.[29]

OPC again urges the Commission to avoid the pitfall of over reliance on usage-based pricing. Instead, it should rely on capacity-based pricing. OPC recommends this approach be consistently applied across a number of areas,

- Loop costs can be recovered on a channel basis.
- Port costs can be recovered on a capacity basis.
- A switching platform can be defined on a capacity basis.

B. Differential Pricing Prior To The Existence Of Substantial Competition Across All Markets Should Not Be Allowed

OPC rejects the suggestion that incumbent LECs be allowed to differentially price before all market segments served from common facilities are fully competitive. Incumbents will certainly use their market power to maximize their profit and competitive position. Residential ratepayers who are certain to be the last to be offered competitive alternatives will suffer the greatest loss. Moreover, because access is an intermediate good, not an end product, the exercise of market power through differential pricing will significantly hurt competition.

OPC took this view in the Local Competition proceeding in presenting its critique of Ramsey pricing.

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[29] OPC, Local Competition, pp. 38-39.

> In no event should the Commission adopt Ramsey pricing as a cost allocation scheme. Ramsey pricing has positive welfare properties only under a very stringent set of assumptions. More importantly, the products should be final products not intermediate goods. Because interconnection services and network elements are intermediate goods, Ramsey pricing may well have negative welfare effects. Indeed, given the critical importance of interconnection services and network elements in the competitive strife between new and incumbent LECs, it is likely that a Ramsey pricing (cost allocation) scheme would weight the balance in favor of incumbent LECs, thus hampering rather than furthering the development of local exchange competition.[30]

Differential pricing in a market that is subject to inconsistent levels of competition should be rejected.

VI. EMBEDDED VS. EFFICIENT COSTS

A. All Forms Of "Make-Whole" Regulatory Policies Should Be Rejected Because They Are Anti-Competitive and Anti-Consumer.

OPC believes that the FCC should take a strong position against "regulatory" approaches that seek to insulate incumbents from the consequences of organizing the telecommunications industry on an efficient, competitive basis. This issue occurs a number times in the Access Charge Notice. OPC already identified many of these same issues in its Local Competition comments.

With respect to the question of embedded costs, OPC argued the following in its Local Competition comments.[31]

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[30] OPC, Local Competition, p. 27.

[31] Access Charge Notice, para 227, 248, 254-258, 263-264.

> The use of historic costs to set rates under sections 251 and 252 violate the directives of the Act. Moreover, the incumbent LECs are already recovering their historic costs. Rates in excess of incremental cost (TSLRIC) is a prescription for over-earning, and will deprive end-users of the full benefits of competition.
>
> First, the Act of 1996 explicitly rejects rate-based costing and pricing practices (see section 252(d)(1)). One might wonder how much more explicit statutory language should be before incumbent LECs and policy makers abandon the obsolete notion that incumbent LECs are entitled to be made "whole." To be sure, competition and provisions that seek to keep the incumbent LEC "whole" are fundamentally incompatible. One must choose one or the other. Congress chose competition.[32]

There is simply no justification for "make whole" policies at the federal or state levels. To the extent that universal service requires companies to charge prices that do not cover economic costs, universal service policies will fill the gap. Allowing recovery of uneconomic costs is anti-competitive and anti-consumer which results in prices above competitive levels, sends the wrong signals to consumers, and creates the potential for a price squeeze.

B. Federal Leadership On "Make-Whole" Tariffs

In our comments on local competition, we offered the following observation on the Commission's role in leading the nation toward competition.

> Furthermore, OPC agrees with the Commission that "national pricing principles would be likely to increase the predictability of rates, and facilitate negotiations, arbitration, and review of agreements between incumbent LECS and competitive providers." Clearly, the greater the degree of uncertainty faced by potential local exchange competitors about regulatory policies across the various jurisdictions, the more difficult it will be for competitors to develop viable entry strategies and the greater might be the required returns expected by investors (after all, the

32 OPC, Local Competition, p. 33.